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Supreme Court of the United States

October Term, 1977

No. 77-95

CONTINENTAL ACCEPTANCE CORP.,
Petitioner,

vs.

GUADALUPE RIVERA,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS, EIGHTH JUDICIAL DISTRICT OF OHIO

BRIEF OF RESPONDENT IN OPPOSITION

LLOYD B. SNYDER
Legal Aid Society of Cleveland
1223 West Sixth Street
Cleveland, Ohio 44113
(216) 687-1900
Counsel for Respondent

Of Counsel:
CAROLYN C. McTIGHE
THOMAS W. WEEKS
Legal Aid Society of Cleveland
and
WILLARD P. OGBURN
National Consumer Law Center
Eleven Beacon Street
Boston, Massachusetts 02108
(617) 523-8010

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STATEMENT OF THE CASE

Statement of Facts[1]

Respondent Rivera entered into a contract on or about May 15, 1970 with the Steel Workers Credit Union (also known as the Federation Workers' Credit Union) for the extension of a consumer credit loan together with credit insurance charges to be paid back in installments totalling $1,959.97. The terms of this transaction were disclosed to Rivera in two documents entitled "Consumer Credit

1. All facts stated herein are taken from the agreed statement as the record on appeal which is set forth in the appendix at pp. A15-A17 of the petition for writ of certiorari.

Disclosure Form for Credit Union" and "Insurance Disclosure and Request for Coverage." Rivera also signed a promissory note.

Sometime thereafter, the credit union filed a petition in bankruptcy, without prior notice, in part due to large scale criminal embezzlement by its management. At the time the bankruptcy action was filed, Rivera had savings of $1,021.22 invested in share accounts in the credit union. He was current on his loan debt and had reduced his outstanding loan balance to $623.58.

During bankruptcy proceedings, the accounts of the credit union, including Rivera's account, were adjusted pursuant to a stipulated plan of settlement accepted by the Bankruptcy Court. A copy of this stipulation is included in Petitioner Continental Acceptance Corporation's appendix at pp. A18-A27. Under the stipulation, Rivera received a credit of less than thirty one cents (31¢) on the dollar for the amount invested in his share account; the credit was directly applied to his outstanding loan balance and reduced the balance to $496.57.

Rivera did not opt out of the stipulated settlement. He was treated as a member of the class. Thereafter, and pursuant to the order of the Bankruptcy Court, the loan portfolio of the credit union with a face value totalling $1,090,000 was sold and transferred to Continental Acceptance Corporation at a purchase price of $150,000.

Statement of the Proceedings Below

On December 19, 1974 Continental filed suit against Rivera in the Cleveland Municipal Court to collect $496.57 allegedly due on Rivera's note. Rivera filed an answer asserting as a defense by way of recoupment that a violation of the disclosure requirements set forth in the federal Truth in Lending Act, 15 U.S.C. §§1601 et seq., had occurred at the time the loan transaction was consummated.

On July 31, 1975 the trial court entered judgment for Continental in the amount of $511.87 (the loan balance plus interest) and ruled that Rivera's recoupment defense was foreclosed by the stipulated settlement in the bankruptcy proceeding and was precluded by the one year statute of limitations set forth in the Truth in Lending Act at 15 U.S.C. §1640(e).

Rivera filed a timely appeal in the Cuyahoga County Court of Appeals. On December 30, 1976 that Court reversed the decision of the trial court and remanded the action with instructions to enter judgment for Rivera. The Appellate Court held that a Truth in Lending Act disclosure violation had occurred and that neither the stipulated settlement in the Bankruptcy Court action nor the statute of limitation in the Truth in Lending Act precluded Rivera from raising the disclosure violation as a recoupment defense.

Continental filed a timely motion to certify the record to the Ohio Supreme Court and set forth the following two propositions of law for review:

> 1. Where facts pleaded in an answer assert a claim long-barred by a specific statute of limitations and call for affirmative action and there is no statute permitting a defendant to raise such a claim, the statute of limitations bars such request for relief despite the fact that the claim is raised for the purpose of reducing a plaintiff's claim.
>
> 2. A claim which is an "extrinsic by-product" of a contractual transaction is in the nature of setoff,

not recoupment, and barred by a specific statute of limitations.

Continental did not appeal from the ruling by the Court of Appeals that a disclosure violation had occurred. Nor did it appeal from the ruling that Rivera's defense was not precluded by the stipulated settlement in the bankruptcy proceeding.

The Ohio Supreme Court overruled Continental's motion to certify the record on April 21, 1977. On July 15, 1977 Continental filed a petition for writ of certiorari in this Court.

ARGUMENT

(A) THE RULING THAT AN OHIO COURT WILL RECOGNIZE A VIOLATION OF THE TRUTH IN LENDING ACT AS A RECOUPMENT DEFENSE TO AN ACTION ON A NOTE BROUGHT IN AN OHIO COURT DOES NOT PRESENT A QUESTION OF FEDERAL LAW.

This action was brought in the Municipal Court of Cleveland, Ohio by Continental Acceptance Corporation to recover $496.57 on a note signed in conjunction with a loan agreement. Continental's claim arose strictly as a matter of state law. The Court of Appeals of Cuyahoga County ruled that the courts of Ohio will recognize a violation of the Truth in Lending Act, 15 U.S.C. §§1601 et seq., as a recoupment defense to such a state law claim. This ruling does not interpret or determine the validity of the federal statute. Rather, it interprets the common

law doctrine of recoupment[2] as recognized by the courts of Ohio. For this reason petitioner is incorrect in invoking the jurisdiction of this Court under 28 U.S.C. §1257(3).

It is noteworthy that the Truth in Lending Act clearly asserts the right of states to require disclosures in credit transactions except for those disclosures that would be inconsistent with the requirements of the federal law. Section 1610(a) of the Act states:

> This title [U.S.C. §§1601 et seq.] does not annul, alter, or affect, or exempt any creditor from complying with, the laws of any State relating to the disclosure of information in connection with credit transactions, except to the extent that those laws are inconsistent with the provisions of this title [15 U.S.C.

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2. Recoupment is an ancient common law doctrine, long established in Ohio, under which a defendant can reduce or defeat a claim by asserting some breach of a duty by the plaintiff as a defense. *Steamboat Wellsville v. Geisse*, 3 Ohio St. 333 (1854); *M. B. Upton & Co. v. I. J. Julian & Co.*, 7 Ohio St. 95 (1857); *Conway v. Ogier*, 115 Ohio App. 251, 184 N.E.2d 681 (1961). The recoupment defense must arise out of the same transaction that gave rise to the plaintiff's claim. *Brunet v. Paper Box Co.*, 16 Ohio N.P. (n.s.) 465, 26 Ohio Dec. 163 (1914). A defense by way of recoupment will not support a recovery greater than the plaintiff's claim, but may only be used to equalize or defeat it.

Under Ohio decisions, a recoupment defense will be heard although an affirmative action raising the claim would be barred by the statute of limitations. *Summers v. Connolly*, 159 Ohio St. 396, 112 N.E.2d 391 (1953); *Mount v. Dircksen*, 118 Ohio App. 371, 194 N.E.2d 903 (1963). Thus, for example, in *Conway v. Ogier, supra*, a physician sued a former patient for a fee. The defendant was permitted, under the doctrine of recoupment, to raise a malpractice claim as a defense to the suit, even though the statute of limitations for an independent malpractice action had already run.

Ohio also has a statute, which was not applied in this case, which permits similar results in some circumstances. §2309.19 O.R.C.; *Benson v. Rosine*, 76 Ohio App. 439, 64 N.E.2d 845 (1945); *Shriner v. Price*, 74 Ohio App. 373, 59 N.E.2d 152 (1944). The doctrine of recoupment is also found in the federal common law, as well as that of many other states, as will be discussed in section B of this brief.

§§1601 et seq.] or regulations thereunder, and then only to the extent of the inconsistency.

Furthermore, the Act specifically permits a state to pass legislation substantially similar to the Truth in Lending Act and authorizes the Federal Reserve Board to exempt any such state from the provisions of the federal law.

> The Board shall by regulation exempt from the requirements of this chapter [15 U.S.C. §§1631 et seq.] any class of credit transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under this chapter [15 U.S.C. §§1631 et seq.], and that there is adequate provision for enforcement. 15 U.S.C. §1633.

Under these provisions a state could pass a disclosure law similar or even identical to the federal law and extend the limitation period for filing suit in state court. It is unreasonable and unwarranted to argue that the same state could not discourage disclosure violations by recognizing its own common law doctrine of recoupment in a state court collection suit. There is certainly nothing contained in section 1640(e) of the Truth in Lending Act that suggests such an unreasonable result.

(B) THE RULING BELOW IS IN CONFORMITY WITH THE FEDERAL COMMON LAW DOCTRINE OF RECOUPMENT AND IS CONSISTENT WITH THE PURPOSES OF THE TRUTH IN LENDING ACT.

Even if federal law rather than the state law of recoupment applies to this case a review of the decisions

of this Court makes clear that the recoupment defense would be authorized in this action.

In *Bull v. United States*, 295 U.S. 247, 55 S. Ct. 695 (1935) the issue was whether a certain sum of money should be subject to income tax or estate tax or both. Executors of the estate of the taxpayer had previously paid estate taxes on the money and were being assessed income taxes on the same funds. The Court held that the money was subject only to income taxes. Although a claim for return of the estate taxes would have been barred by the statute of limitations, this Court allowed the estate tax overpayment to be raised as a recoupment defense to the assessment of income taxes. In so holding the court said:

> [r]ecoupment is in the nature of a defense *arising out of some feature of the transaction* upon which the plaintiff's action is grounded. Such a defense is never barred by the statute of limitations so long as the main action itself is timely. 295 U.S. at 262 (emphasis added.)

The holding of the *Bull* case *supra*, applies to the case at bar. Continental attempts to avoid the force of the *Bull* decision by arguing that the statute of limitations in the Truth in Lending Act is "jurisdictional" and somehow bars any claim including recoupment based upon a violation of the Act after one year. See brief of petitioner at pp. 8-9. Continental has cited no case that has so held.

The same argument was made to this Court and rejected in the case of *United States v. Western Pacific Railroad Co.*, 352 U.S. 59, 77 S. Ct. 161 (1956). In that case a rail carrier sued the United States under the Tucker Act, 28 U.S.C. §2501, for failure to pay the proper tariff

rates for a shipment. The government defended by arguing that a lower rate was applicable; it further asserted that if the higher tariff were applicable, then the rate was unreasonable. An affirmative action to contest the reasonableness of the rate would have been barred by the limitation clause in the Interstate Commerce Act, 49 U.S.C. §16(3)(a).

In holding that the government's claim of unreasonableness could be raised despite the passage of the limitation period, the Court said:

> [t]he basic policy behind statutes of limitations has no relevance to the situation here. The purpose of such statutes is to keep stale litigation out of the courts. They are aimed at lawsuits, not at the consideration of particular issues in lawsuits. Here the action was already in court and held to have been brought in time. To use the statute of limitations to cut off the consideration of a particular defense in the case is quite foreign to the policy of preventing the commencement of stale litigation. We think it would be incongruous to hold that once a lawsuit is properly before the court, decision must be made without consideration of all the issues in the case and without the benefit of all the applicable law. If this litigation is not stale, then no issue in it can be deemed stale.

It is argued that this Court has construed §16(3) as "jurisdictional" and that the Commission is therefore barred absolutely from hearing questions as to the reasonableness of rates arising in suits brought after two years, whether such questions come to the Commission by way of referral or in an original suit. . . . But here the Government is not asserting a right

> to affirmative recovery. It is seeking only to have adjudicated questions raised by way of defense. *It is therefore irrelevant whether the statute of limitations is "jurisdictional" or not*; the question would still remain whether Congress intended it to apply to referrals as well as to affirmative suits . . .
>
> *We hold, therefore, that the limitation of §16(3) does not bar a reference to the Interstate Commerce Commission of questions raised by way of defense* and within the Commission's primary jurisdiction, as were these questions relating to the applicable tariff. 352 U.S. at pp. 72-74 (emphasis added.)

In a similar vein this Court has ruled that labeling a limitation "substantive" rather than "procedural" does not restrict the ability of a court to toll the limitation period in appropriate circumstances. In *American Pipe and Construction Co. v. Utah,* 414 U.S. 538, 94 S. Ct. 756 (1974) certain purported class members attempted to intervene in an antitrust suit following denial of class certification by the trial court. Defendant argued that the attempted intervention was barred by the limitation set forth in the Clayton Act, 15 U.S.C. §15(b) and 15 U.S.C. §16(b).

The Court, after reviewing a number of previous decisions, refused to decree that a right is extinguished for all purposes by the passage of time because the limitation period in a statute is deemed substantive. The Court stated:

> These cases fully support the conclusion that the mere fact that a federal statute providing for substantive liability also sets a time limitation upon the institution of suit does not restrict the power of the

federal courts to hold that the statute of limitations is tolled under certain circumstances not inconsistent with the legislative purpose. 414 U.S. at 559

This Court has made it clear in the decisions cited above that a recoupment defense is permissible whenever the main action is timely. Petitioner cannot meritoriously claim that a defense can be barred merely by calling a limitation on bringing an affirmative action "substantive" as opposed to "procedural" or by deeming the limitation to be "jurisdictional".

The case at bar is a classic example of a case to which the doctrine of recoupment applies. Respondent Rivera had savings of $1,021.22 invested in a credit union; he had a loan outstanding from the credit union. When the credit union filed a petition in bankruptcy, Rivera lost his savings and had his loan balance reduced by $127.01. Continental Acceptance Corporation purchased the loan accounts of the credit union for less than fourteen cents (14¢) per dollar and sought to collect the loan balance under the contract entered into between Rivera and the credit union.

Continental does not dispute the fact that in the course of entering into the contract it seeks to enforce, the credit union violated the Truth in Lending Act. The only documents that evidence the contract entered into by Rivera and the assignor of Continental are a form entitled "Consumer Credit Disclosure Form for Credit Union," a separate credit insurance form, and a promissory note, all of which were executed on May 15, 1970. These very documents establish the existence of the disclosure violations asserted by Rivera. Thus the same documents that support Continental's claim for relief establish the violation that supports Rivera's recoupment claim. It would be

incongruous to hold that a court is bound to enforce contract claims evidenced by documents signed by the parties to the contract, but that the court is prohibited from reviewing the same documents to determine whether in the course of entering into the contract one of the parties violated a federal law designed for the protection of the other party.

Moreover, permitting recoupment defenses furthers a fundamental policy of the Truth in Lending Act. Enforcement of the Act by private litigation is strongly encouraged. The Act provides a simple mechanism for determining damages based upon the amount of finance charges assessed and limited by minimum and maximum awards. 15 U.S.C. §1640(a). The Act requires the payment of reasonable attorney's fees in any successful action. 15 U.S.C. §1640 (a)(3). It would be inconsistent with the policy of encouraging private enforcement of the Act to bar determination of violations in recoupment cases.

Barring recoupment defenses would be inconsistent with the very policy of statutes of limitations of preventing stale claims from being adjudicated by the courts. Such a decision would encourage creditors to wait for one year before bringing suit to collect on delinquent debts. The effect would be to reward creditors who allow claims to become stale rather than to encourage prompt litigation of disputes. As this court stated in *United States v. Western Pacific Railroad Co., supra*:

> We may assume without deciding, that the Government would have been barred by §16(3) from filing an affirmative suit before the Commission to recover overcharges from a carrier. Nevertheless we do not think that the statute operates to bar reference to the Commission of questions raised by way of defense

in suits which are themselves timely brought. Respondents in effect ask us to hold that a suit may be brought for six years but that certain defenses thereto may be raised only for two years. *Only the clearest congressional language could force us to a result which would allow a carrier to recover unreasonable charges with impunity merely by waiting two years before filing suit.* 352 U.S. at p. 71. (emphasis added.)

(C) PETITIONER'S CONTENTION THAT SECTION 1640(h) OF THE TRUTH IN LENDING ACT PROHIBITS A STATE COURT FROM RECOGNIZING A VIOLATION OF THE ACT AS A RECOUPMENT DEFENSE WAS NOT RAISED BELOW, IS NOT PROPERLY BEFORE THIS COURT, AND RESTS UPON A MISINTERPRETATION OF THE STATUTE.

In the questions presented for review petitioner questions whether Rivera's Truth in Lending defense is foreclosed by the offset provision of the Act, 15 U.S.C. §1640(h). There is, however, no discussion of this issue in petitioner's brief except for an admission that the issue was not briefed in the Court of Appeals below. (See petitioner's argument in support of petition for Writ of Certiorari at p. 16 n.9.) In addition, Continental failed to raise the issue in its motion to certify the record to the Supreme Court of Ohio. (See Continental's propositions of law to the Supreme Court of Ohio set forth in Respondent's Statement of the Case, *supra.*) Because petitioner failed to raise this issue below, it is not properly before this court now. *Adickes v. S. H. Kress and Co.*, 398 U.S. 144, 147, 90 S. Ct. 1598, 1602-1603 n.2 (1970); *Lawn* v. *United States*, 355 U.S. 339, 362-363, 78 S. Ct. 311, 324-325 n.16 (1958).

It should also be pointed out that section 1640(h) by its terms has nothing to do with the statute of limitations or recoupment. The Senate Report that discusses the section describes its purpose as follows:

> The Committee amended bill also provides that a consumer may not recover damages (other than actual damages) by right of offset unless the consumer was a party to a court action in which the liability was determined. This provision is intended to prevent consumers from simply deducting from their obligation to a creditor the minimum $100 award, which is provided for in individual actions, without being a party to an action in which such a liability is determined by a court. However, nothing in this action prevents a series of individual civil actions to recover $100 in the case of any violation.
>
> S. Rep. No. 93-278, 93d Cong., 1st Sess. (1973) at 16.

Nothing in the statute or the legislative history supports the contention that section 1640(h) was intended to have any effect upon the recoupment issue now before this Court. This conclusion is further supported by a recently proposed amendment to the Truth in Lending Act. In introducing a bill to amend the Act, Senator Proxmire, a sponsor of the original Act and a member of the Senate Subcommittee on Consumer Affairs of the Committee on Banking, Housing and Urban Affairs, has proposed the following amendment to section 1640(h):

> SEC. 14. Section 130(h) of the Truth in Lending Act is amended by adding at the end thereof the following new sentence: "This subsection may not be construed to prohibit such person from raising a creditor's violation of this title by way of recoupment,

offset, or counterclaim in an action before a court of competent jurisdiction where permitted by law."

S. 1312 95th Cong., 1st Sess., Introduced April 20, 1977.

Senator Proxmire explained the reason for the amendment in these terms:

SEC. 14. Set-off rights.—Would amend section 130(h) of the Truth in Lending Act to make clear that this section, which prohibits a borrower from offsetting Truth in Lending damages against a debt owed unless a court has found a Truth in Lending violation, does not prohibit a borrower from raising a creditor's violation by way of recoupment or similar doctrine where permitted by State law. It was Congress' intent in enacting this section in 1974 to prohibit a debtor from unilaterally offsetting alleged damages but not to prohibit the borrower from seeking an offset in a legal action. This amendment will supersede an erroneous court decision on this subject.

Section by section analysis of S. 1312.

There can be little doubt that section 1640(h) is irrelevant to the issue before this Court.

As this proposed amendment makes clear, the very issue raised by petitioner herein is receiving Congressional attention. Passage of the amendment would render the issue moot. Under these circumstances there would seem to be little reason for this Court to exercise its discretionary power to review the decision below on writ of certiorari.

(D) PETITIONER'S CONTENTION THAT A SETTLEMENT PLAN IN AN UNRELATED BANKRUPTCY ACTION IS SOMEHOW RELATED TO THE ISSUES IN THIS ACTION WAS NOT RAISED BELOW AND IS NOT PROPERLY BEFORE THIS COURT.

Petitioner also questions whether the decision below is inconsistent with a consented settlement plan in an unrelated bankruptcy action. That issue raises no federal statutory issues for review by this Court. Moreover, petitioner neither raised this issue as a proposition of law nor submitted a memorandum in support of it in its motion to certify the record to the Supreme Court of Ohio. It is therefore precluded from raising the issue before this Court. *Adickes v. S. H. Kress and Co., supra; Lawn v. United States, supra.*

CONCLUSION

For the foregoing reasons Respondent Rivera submits that the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

LLOYD B. SNYDER
Legal Aid Society of Cleveland
1223 West Sixth Street
Cleveland, Ohio 44113
(216) 687-1900
Counsel for Respondent

Of Counsel:

CAROLYN C. MCTIGHE
THOMAS W. WEEKS
Legal Aid Society of Cleveland

and

WILLARD P. OGBURN
National Consumer Law Center
Eleven Beacon Street
Boston, Massachusetts 02108
(617) 523-8010